

**UNIVERSITY OF VIRGINIA MEDICAL CENTER  
RICHMOND, VIRGINIA**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 1999**

***AUDITOR OF  
PUBLIC  
ACCOUNTS***



***COMMONWEALTH OF VIRGINIA***

- TABLE OF CONTENTS -

INDEPENDENT AUDITOR'S REPORTS:

[Auditor's Report on Financial Statements](#)

[Auditor's Report on Internal Controls and Compliance](#)

FINANCIAL STATEMENTS:

[Balance Sheets](#)

[Statements of Revenues and Expenses - General Funds](#)

[Statements of Changes in Fund Balances](#)

[Statements of Cash Flows - General Funds](#)

[Notes to Financial Statements](#)

UNIVERSITY OFFICIALS

October 15, 1999

The Honorable James S. Gilmore, III  
Governor of Virginia

The Honorable Richard J. Holland  
Chairman, Joint Legislative Audit  
and Review Commission

The Board of Visitors  
University of Virginia

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the balance sheets of the **University of Virginia Medical Center**, a component unit of the Commonwealth of Virginia, as of June 30, 1999 and 1998, and the related statements of revenues and expenses, changes in fund balances, and cash flows for the years then ended. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center at June 30, 1999 and 1998, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

AUDITOR OF PUBLIC ACCOUNTS

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## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROLS AND COMPLIANCE

Our report on internal controls and compliance and recommendations for improvements in internal controls relative to the Medical Center's operations are included in our report on the total operations of the University of Virginia for the year ended June 30, 1999.

UNIVERSITY OF VIRGINIA MEDICAL CENTER  
BALANCE SHEETS  
As of June 30, 1999 and 1998

	1999	1998
A S S E T S		
General funds:		
Current assets:		
Cash and cash equivalents (Note 3)	\$ 59,297,748	\$ 67,060,761
Accounts receivable, net of estimated uncollectibles of \$53,936,788 at June 30, 1999 and \$48,973,924 at June 30, 1998	53,469,274	60,776,150
Due from third-party payors	11,009,532	9,469,724
Inventories and prepaid expenses	9,727,035	7,972,972
Notes receivable (Note 7)	7,141,919	4,019,226
Total current assets	\$140,645,508	149,298,833
Other assets:		
Property, plant and equipment, less accumulated depreciation of \$277,207,333 at June 30, 1999 and \$253,449,568 at June 30, 1998 (Note 6)	216,039,646	218,004,811
Deferred bond discount and issue costs, net of amortization of \$838,024 at June 30, 1999 and \$3,495,096 at June 30, 1998	692,488	2,335,046
Advance to the University (Note 5)	2,414,829	2,798,708
Goodwill (Note 8)	1,170,000	1,530,000
Investments (Note 3)	5,204,466	4,926,588
Investments in affiliated companies (Note 7)	1,391,859	3,261,935
Total other assets	226,913,288	232,857,088
Assets whose use is limited (Note 4):		
Cash and cash equivalents (Note 3)	12,816,946	14,229,255
Investments (Note 3)	130,218,470	108,914,839
Total noncurrent limited assets	143,035,416	123,144,094
Total assets	<u>\$ 510,594,212</u>	<u>\$ 505,300,015</u>
Restricted funds:		
Specific purpose funds:		
Cash and cash equivalents (Note 3)	\$ 3,134,912	\$ 2,512,204
Advance to the University (Note 5)	2,377,919	2,443,199
Total assets	<u>\$ 5,512,831</u>	<u>\$ 4,955,403</u>
Plant replacement and expansion funds:		
Cash and cash equivalents (Note 3)	\$ 11,982	\$ 11,982
Total assets	<u>\$ 11,982</u>	<u>\$ 11,982</u>
Endowment funds:		
Investments in pooled endowment funds (Note 3)	<u>\$ 16,159,877</u>	<u>\$ 15,127,004</u>

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER  
BALANCE SHEETS  
As of June 30, 1999 and 1998

	1999	1998
LIABILITIES AND FUND BALANCES		
General funds:		
Current liabilities:		
Current installments of long-term debt (Note 14)	\$3,834,400	\$3,551,900
Accounts payable and accrued expenses	32,478,315	33,085,397
Retainage payable	35,748	-
Total current liabilities	36,348,463	36,637,297
Long-term liabilities:		
Long-term debt (Note 14)	91,505,000	92,645,000
Bond premium, net of amortization of \$27,387	1,529,134	-
Accrued leave	12,418,335	12,990,699
Total long-term liabilities	105,452,469	105,635,699
Total liabilities	141,800,932	142,272,996
Fund balances	368,793,280	363,027,019
Total liabilities and fund balances	\$ 510,594,212	\$ 505,300,015
Restricted funds:		
Specific purpose funds:		
Fund balances	\$ 5,512,831	\$ 4,955,403
Plant replacement and expansion funds:		
Fund balances	\$ 11,982	\$ 11,982
Endowment funds:		
Fund balances	\$ 16,159,877	\$ 15,127,004

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER  
STATEMENTS OF REVENUES AND EXPENSES - GENERAL FUNDS  
For the Years Ended June 30, 1999 and 1998

	1999	1998
Net patient service revenue (Note 2)	\$ 459,032,698	\$ 450,789,936
Other revenue:		
University allocations (Note 10)	8,338,916	18,044,181
Other (including \$299,764 in 1999 and \$463,712 in 1998 from specific purpose funds)	12,255,810	14,805,211
Total other revenue	20,594,726	32,849,392
Total revenue	479,627,424	483,639,328
Expenses:		
Salaries and wages	164,944,610	158,708,454
Fringe benefits	40,048,693	38,356,750
Purchased services	114,959,818	118,482,248
Supplies	88,482,218	82,626,563
Other expenses	9,279,852	9,073,158
Provision for depreciation	30,298,073	30,828,681
Amortization	568,373	557,423
Interest expense	5,450,267	5,825,177
Provision for bad debts	15,502,007	16,076,354
Total expenses	469,533,911	460,534,808
Income from operations	10,093,513	23,104,520
Nonoperating gains (losses):		
Investment income from trustee held funds	7,771,019	7,426,938
Net (decrease) increase in the fair value of investments	(1,979,182)	700,215
Net loss from investments in affiliated companies (Note 7)	(7,100,076)	(8,921,694)
Other	813,970	(1,073,620)
Loss on disposal of fixed assets	(959,863)	(1,405,959)
Nonoperating (losses), net	(1,454,132)	(3,274,120)
Revenue and gains in excess of expenses and losses	8,639,381	19,830,400
Extraordinary loss on early extinguishment of debt (Note 13 )	(2,925,551)	-
Revenue and gains in excess of expenses, losses and extraordinary loss	\$ 5,713,830	\$ 19,830,400

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER  
STATEMENTS OF CHANGES IN FUND BALANCES  
For the Years Ended June 30, 1999 and 1998

	1999	1998
General funds:		
Balances at beginning of year	\$ 363,027,019	\$ 342,854,976
Revenue and gains in excess of expenses and losses	5,713,830	19,830,400
Transferred from:		
Specific purpose funds	52,431	341,643
Balances at end of year	<u>\$ 368,793,280</u>	<u>\$ 363,027,019</u>
Restricted funds:		
Specific purpose funds:		
Balances at beginning of year	\$ 4,955,403	\$ 4,405,889
Private gifts, grants and contracts	476,059	415,246
Endowment income	152,249	863,084
Interest income	262,065	194,064
Transferred to:		
Other revenue	(299,764)	(463,712)
The University	19,250	(117,525)
General funds	(52,431)	(341,643)
Balances at end of year	<u>\$ 5,512,831</u>	<u>\$ 4,955,403</u>
Plant replacement and expansion funds:		
Balances at beginning of year	\$ 11,982	\$ 11,982
Balances at end of year	<u>\$ 11,982</u>	<u>\$ 11,982</u>
Endowment funds:		
Balances at beginning of year	\$ 15,127,004	\$ 13,740,598
Net increase in fair value of investments	1,032,873	1,386,406
Balances at end of year	<u>\$ 16,159,877</u>	<u>\$ 15,127,004</u>

The accompanying notes to financial statements are an integral part of this statement.



UNIVERSITY OF VIRGINIA MEDICAL CENTER  
STATEMENTS OF CASH FLOWS - GENERAL FUNDS  
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS  
For the Years Ended June 30, 1999 and 1998

	1999	1998
Cash flows from operating activities:		
Income from operations	\$ 10,093,513	\$ 23,104,520
Reconciliation of income from operations to net cash provided by operating activities:		
Provision for depreciation	30,298,073	30,828,681
Amortization of bond issue costs and goodwill	568,373	557,423
Increase in provision for losses on accounts receivable	4,962,864	9,697,285
Interest payments for capital and related financing activities	5,450,267	5,825,177
Increase in goodwill	-	(1,530,000)
(Increase)decrease in accounts receivable	2,344,012	(18,071,149)
(Increase)decrease in amounts due from third-party payors	(1,539,808)	5,873,084
Increase in inventories and prepaid expenses	(1,754,063)	(287,309)
Increase in notes receivable	(3,122,693)	(3,960,433)
(Decrease)increase in accounts payable and accrued expenses	272,697	(4,174,374)
(Increase)decrease in accrued leave	(572,364)	1,404,878
Net cash provided by operating activities	47,000,871	49,267,783
Cash flows from capital and related financing activities:		
Payment of principal and interest on long-term debt	(9,029,483)	(9,261,877)
Net change in cash, cash equivalents, investments and accrued interest of trustee held funds and unrestricted investments	(22,148,386)	(20,200,231)
Proceeds from issuance and incurrence of long-term debt	60,144,500	-
Escrow payments for defeased bonds	(58,264,792)	-
Acquisition and construction of capital assets	(29,478,150)	(22,578,700)
Increase in retainage payable	35,748	-
Proceeds from sale of equipment	185,380	306,073
Transferred from restricted funds	52,431	341,643
Net cash used for capital and related financing activities	(58,502,752)	(51,393,092)
Cash flows from investing activities:		
Repayment of advance to the University	383,878	-
Investment income from trustee held funds	7,771,019	7,426,938
Loss from investments in affiliated companies	(7,100,076)	(8,921,694)
Endowment and interest income	813,971	1,057,149
Decrease in cumulative net loss in investment in affiliated companies	-	(5,158,425)
(Increase)decrease in investment in affiliated companies	1,870,076	(1,019,880)
Net cash provided by investing activities	3,738,868	(6,615,912)
Net decrease in cash and cash equivalents	(7,763,013)	(8,741,221)
Cash and cash equivalents at the beginning of the year	67,060,761	75,801,982
Cash and cash equivalents at the end of the year	\$ 59,297,748	\$ 67,060,761

The accompanying notes to financial statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 1999 and 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Mission

The University of Virginia Medical Center (the Medical Center) is a division of the University of Virginia (the University). The Medical Center's mission is to enrich the quality of human life by improvement of health, advancement of medical and scientific knowledge, and by creation of an environment for professional preparation of individuals dedicated to health care service. Only those activities directly associated with the furtherance of this mission are considered to be operating activities. Other activities that result in gains or losses unrelated to the Medical Center's primary mission are considered to be nonoperating.

A separate report is prepared for the Commonwealth of Virginia (the Commonwealth) that includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Medical Center is a component unit of the Commonwealth of Virginia and is included in the general purpose financial statements of the Commonwealth.

B. Basis of Accounting

The Medical Center has adopted the accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB) for providers of health care services.

C. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

D. Accounting Standards

Pursuant to Governmental Accounting Standards Board Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Medical Center has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board, including those issued after November 30, 1989.

E. Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources, the accounts of the Medical Center are maintained in accordance with the principles of fund accounting.

General funds are used to reflect resources of the Medical Center that are not restricted by a donor or grantor. Assets whose use is limited in substance under terms of debt indentures, trust agreements, fiduciary responsibilities, or Board restrictions are reported in the general funds section as "Assets whose use is limited."

Resources restricted as to use by a donor or a grantor are segregated in restricted funds and are classified under the following categories:

Specific Purpose Funds - account for funds received from donors and other third parties for specific operating purposes. Restricted funds are reported as general funds revenue when expended.

Plant Replacement and Expansion Funds - account for funds received from donors and other third parties for additions to property, plant, and equipment. When expended, these funds are recorded as transfers to the general funds.

Endowment Funds - account for funds received from donors and other third parties for specific purposes where the principal must be invested and remain intact and only the income is available for spending. Income of endowment funds is recorded as nonoperating gains if unrestricted and specific purpose fund additions if restricted.

F. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, and includes funds from the General Fund of the Commonwealth of Virginia and estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis, in the period the related services are rendered, and adjusted in future periods as final settlements are determined.

G. Indigent Care

The Medical Center accepts all patients regardless of their ability to pay. A patient is classified as indigent by reference to established Commonwealth policies. The criteria for identifying indigent patients are based on asset and income guidelines that are updated annually in accordance with the Federal Poverty Income Guidelines as provided by the Federal Office of Management and Budget. Because the Medical Center does not pursue collection of amounts determined to qualify as indigent care, they are not reported as revenue.

H. Receivables From Third Parties and Contractual Adjustments

A significant portion of the Medical Center's services is rendered to patients covered by Medicare, Medicaid, or Blue Cross. The Medical Center has entered into contractual agreements with these third parties to accept payment for services in amounts less than scheduled charges.

Certain annual settlements of amounts due for patient services covered by third parties are determined through cost reports that are subject to audit and retroactive adjustment by the third parties. Provisions for possible adjustments of cost reports have been estimated and reflected in the accompanying financial statements. Since the determination of cost reimbursement settlements of amounts earned in prior years has been based on reasonable estimation, the difference in any year between the originally estimated amount and the final determination is reported in the year of determination.

I. Investments

Donated investments are reported at the fair market value at the date of receipt. The major portion of the investments of the Medical Center's endowment funds is pooled under the University of Virginia Growth and Income Fund, the general endowment pool for the University. Annually, endowment earnings on the consolidated endowment pool are distributed to the participating funds based on the participating share of each fund in the pool.

Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* was implemented during 1998; accordingly, investments are carried at fair value as determined by quoted market prices. Unrealized appreciation or depreciation of investments is included in the current period net earnings.

Investments in affiliated companies are reported using the equity method of accounting.

J. Inventories

Inventories are valued at the lower of cost, generally determined on the weighted average method, or market.

K. Property, Plant and Equipment

Property, plant, and equipment are stated at cost, or if donated, at fair market value at the date of donation. The Medical Center capitalizes expenditures for equipment costing \$500 or more and having a useful life of two years or greater in accordance with the Medicare Reimbursement Manual.

Depreciation on property, plant, and equipment, excluding land and construction in progress, is computed over the estimated useful lives of the assets using the straight-line method. The general range of estimated useful lives is 10 to 40 years for buildings and fixtures and 3 to 20 years for equipment.

The Medical Center utilizes the half-year convention for recognizing depreciation expense related to equipment, both fixed and moveable. A half-year of depreciation is recognized on all equipment in the fiscal year of acquisition. Likewise, a half-year of depreciation is recognized in the fiscal year at the end of the equipment's useful life. Depreciation on buildings is recognized from the date that the asset is placed in service to the date on which it is retired.

L. Deferred Bond Issue Costs, Discounts, and Premiums

Deferred bond issue costs, discounts, and premiums are amortized over the remaining life of the bonds.

M. Assets Whose Use Is Limited

Assets whose use is limited include assets held by trustees under indenture agreements.

N. Accrued Leave

Salaried employees' attendance and leave regulations make provision for the granting of a specified number of days of leave each year. The amounts recorded on the balance sheet reflect all earned leave not taken and the amount payable under the catastrophic leave pay-out policy upon termination, which is the lesser of 25 percent of sick leave not taken or \$5,000 per employee with five years or more of service. The liability is based on the probability that an employee with less than five years of service will eventually become vested and have a right to receive payment for sick leave benefits. The liability also includes related FICA taxes.

O. Appropriations and Disproportionate Share Payments

The Medical Center's appropriations from the General Fund of the Commonwealth for indigent care and medical education costs have been replaced by disproportionate share payments paid by the Department of Medical Assistance Services, but funded by the Commonwealth of Virginia. These payments are recorded as net patient service revenue in the Medical Center's General Fund in the year received.

P. Cash and Cash Equivalents

Cash and cash equivalents include cash and all highly liquid investments with a maturity of three months or less when purchased. For the statement of cash flows, cash and cash equivalents whose use is limited are not subject to the immediate use by the Medical Center and, therefore, are not included in the beginning or ending balance of cash and cash equivalents.

Q. Reclassifications

Certain amounts from prior year statements have been reclassified to conform with current year presentation.

## 2. NET PATIENT SERVICE REVENUE

The Medical Center's patient service revenue is as follows for the years ended June 30:

	<u>1999</u>	<u>1998</u>
Gross patient service revenue:		
Inpatient:		
Routine services	\$128,237,986	\$125,914,971
Ancillary services	269,757,918	258,170,761
Outpatient:		
Ancillary services	168,277,780	141,362,770
Clinics	<u>6,502,150</u>	<u>10,429,954</u>
Total gross patient service revenue	572,775,834	535,878,456
Allowances for indigent care and contractual adjustments	<u>(113,743,136)</u>	<u>(85,088,520)</u>
Net patient service revenue	<u>\$459,032,698</u>	<u>\$450,789,936</u>

The Medical Center received \$35,120,339 in each of fiscal years 1999 and 1998 for disproportionate share payments from the Department of Medical Assistance Services that were funded by the Commonwealth of Virginia for patients that are indigent. These payments are included in net patient service revenue as an adjustment of allowances for indigent care and contractual adjustments.

Amounts written off for indigent care net of the disproportionate share payments in 1999 and 1998 were \$24,510,434 and \$22,754,534, respectively.

## 3. CREDIT RISK UNDERLYING CASH, CASH EQUIVALENTS, AND INVESTMENTS

### A. Cash and cash equivalents

All Medical Center cash is fully collateralized in accordance with the Virginia Security for Public Deposits Act (Section 2.1-359, et seq. of the Code of Virginia). All cash except for \$1,400,294 at June 30, 1999, and \$1,337,396 at June 30, 1998, is in accounts of the University of Virginia or with the Treasurer of Virginia. The bank balance of the excluded cash was \$172,899 at June 30, 1999 and \$16,212 at June 30, 1998.

Each fund's equity in pooled University or state funds is reported as "Cash and cash equivalents" on the accompanying balance sheet and is not categorized as to credit risk, except for \$12,816,946 and \$14,229,255 at June 30, 1999 and 1998, respectively, of assets whose use is limited. These assets consist of repurchase agreements considered to be Category 1 as defined below.

B. Investments

The resolutions authorizing Series 1993A, 1998B, and 1999A Bonds require that the Medical Center establish and maintain various funds to be held by the Treasurer of Virginia. The resolutions mandate funding requirements at the time of the bonds' sale and during and after the construction period. These funds are invested and held by the Treasurer of Virginia.

Investments are categorized by levels of credit risk in accordance with Governmental Accounting Standards Board Statement No. 3, as described below:

Category 1 - Insured or registered securities or securities held by the Medical Center or its agent in the Medical Center's name.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Medical Center's name.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the Medical Center's name.

As of June 30, 1999

<u>Description</u>	<u>Category 1</u>	<u>Non-Categorized</u>	<u>Total</u>
US Government and US Government Agency Securities:			
U.S. Treasury Notes	\$ 10,146,250	\$ -	\$ 10,146,250
FNMA	100,632,939	-	100,632,939
FHLMC	1,937,029	-	1,937,029
FHLB	17,795,780	-	17,795,780
FFCB	4,910,938	-	4,910,938
University of Virginia Growth and Income Fund	<u>-</u>	<u>16,159,877</u>	<u>16,159,877</u>
Total	<u>\$135,422,936</u>	<u>\$16,159,877</u>	<u>\$151,582,813</u>

As of June 30, 1998

<u>Description</u>	<u>Category 1</u>	<u>Non-Categorized</u>	<u>Total</u>
US Government and US Government Agency Securities:			
U.S. Treasury Notes	\$ 17,230,313	\$ -	\$ 17,230,313
FNMA	84,935,995	-	84,935,995
FHLMC	6,692,306	-	6,692,306
SLMA	4,982,813	-	4,982,813
University of Virginia Growth and Income Fund	<u>-</u>	<u>15,127,004</u>	<u>15,127,004</u>
Total	<u>\$113,841,427</u>	<u>\$15,127,004</u>	<u>\$128,968,431</u>

4. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited consists of assets held by trustees under indenture agreements.

The Series 1993A, 1998B, and 1999A Bond resolutions require that deposits be made in a specific order to various accounts and funds held by the Treasurer of Virginia as follows:

- A. to the credit of the Interest Account on a monthly basis, the amount of interest due and payable on the first day of the succeeding month with respect to the bonds of each series then outstanding;
- B. to the credit of the Principal Account on an annual basis, the amount sufficient to pay maturing principal of all bonds on the next principal payment date;
- C. to the credit of the Sinking Fund Account, the amount sufficient to retire all bonds to be called by mandatory redemption on the next ensuing mandatory redemption date;
- D. to the credit of the Reserve Fund, the amount necessary to fund the Reserve Account Requirement, as defined by the bond resolution;
- E. to the credit of the Depreciation Reserve Fund, commencing on December 1, 1988, and each December 1 thereafter, 100 percent of the Depreciation Reserve Fund Requirement as defined by the bond resolution, for each year;
- F. to the credit of any other fund or account created pursuant to an applicable Series Resolution.

Funds held by Trustees, restricted by bond agreements consist of the following as of June 30:

<u>Assets</u>	<u>1999</u>	<u>1998</u>
Construction Fund	\$ 7,288,493	\$ 588,514
Bond Issue Cost – 1993A	-	20,107
Bond Sinking Fund - 1999A	27,958	-
Bond Sinking Fund - 1993A	19,086	13,529
Bond Sinking Fund – 1998B	799	-
Bond Sinking Fund – 1999A	2,719	-
Reserve Fund - Series E	-	5,749
Depreciation Reserve	<u>135,696,361</u>	<u>122,516,195</u>
Total assets	<u>\$143,035,416</u>	<u>\$123,144,094</u>

5. ADVANCE TO THE UNIVERSITY

During 1996, the Board of Visitors authorized the University to loan the University of Virginia Real Estate Foundation (UREF) up to \$7,000,000 to construct the Virginia Neurological Institute building. The Medical Center advanced \$2,854,410 of General Funds and \$2,858,395 of Specific



Purpose Funds to the University's Quasi Endowment Fund, which was loaned to UREF for the construction of the building. Advance amounts include interest earnings capitalized to the advances. As the loan to UREF is repaid, the advance from the Medical Center will also be repaid.

## 6. PROPERTY, PLANT, AND EQUIPMENT

A summary of the property, plant and equipment accounts and the related accumulated depreciation consists of the following as of June 30:

	<u>1999</u>	<u>1998</u>
Land	\$ 2,280,953	\$ 1,810,953
Land improvements	7,115,580	7,103,875
Buildings	286,087,212	275,077,208
Fixed equipment	16,250,053	16,563,161
Moveable equipment	177,208,640	165,522,319
Construction in progress	<u>4,304,540</u>	<u>5,376,863</u>
Total	<u>493,246,979</u>	<u>471,454,379</u>
Accumulated depreciation	<u>(277,207,333)</u>	<u>(253,449,568)</u>
Property, plant and equipment, net	<u>\$216,039,646</u>	<u>\$218,004,811</u>

## 7. AFFILIATED COMPANIES

### Blue Ridge Health Alliance, Inc.

The Medical Center is a participant with the Health Services Foundation (HSF) in Blue Ridge Health Alliance, Inc. (Blue Ridge Health Alliance or the Corporation), a joint venture to develop and operate a managed health care organization in central and western Virginia and certain counties in West Virginia. Blue Ridge Health Alliance, a for-profit corporation, was formed in April 1994 to develop a regional network of physicians, hospitals, and other health care providers through which to deliver health benefits to insured and self-funded employers and other groups. QualChoice of Virginia Health Plan, Inc. (QualChoice), is a wholly-owned subsidiary of the Corporation formed to operate a health maintenance organization (HMO) serving employers and other groups in the Commonwealth of Virginia. QualChoice commenced operations on January 4, 1995.

Blue Ridge Health Alliance has authorized capital stock consisting of one million two (1,000,002) shares of common stock, par value \$0.01 per share (the "Common Stock"). The authorized shares of common stock consist of 1,000,000 shares of Class A Voting Common Stock and two shares of Class B Voting Common Stock. In 1994, the Medical Center and the HSF each executed a Shareholders Subscription Agreement under which each agreed to contribute \$4,550,000 as equity capital. Subsequently, the Medical Center and HSF each were issued one share of Class B Voting Common Stock and shares of Class A Voting Common Stock. Except for the original obligations of the

founding shareholders under the Founding Shareholders Subscription Agreements, no shareholder has an obligation to make any loans, advances, or additional equity contributions whatsoever to the capital of the Corporation. The shareholders have acknowledged and agreed that the Corporation is expected to retain its earnings in order to finance growth and that there is no expectation that the Corporation will pay any cash dividends in the foreseeable future.

The Medical Center contributed a total of \$15,000,000 to Blue Ridge Health Alliance during the period ended June 30, 1998. Also, on April 6, 1998, the Medical Center loaned \$3,800,000 to the Corporation due on July 6, 1998, and bearing interest at 6.25 percent per annum. In July 1998, the Board of Directors of the Corporation issued a capital call to HSF and the Medical Center for \$5,000,000. HSF elected not to participate in this capital call in accordance with their rights prescribed in the Shareholders Agreement; accordingly, the Medical Center contributed the entire \$5,000,000, by converting the \$3,800,000 loan to capital and contributing \$1,200,000 in cash. This contribution increased the Medical Center's percentage ownership to 52.05 percent. By agreement between HSF and the Medical Center, HSF relinquished its share of Class B Voting Common Stock to the Medical Center. Corporate actions enumerated in the Amended Articles of Incorporation require approval of the holders of all of the shares of the Class B Voting Common Stock. Except for this special voting requirement, the shares of Class A and Class B Voting Common Stock have equal rights, privileges, and dividend distribution rights. On November 25, 1998, the Medical Center provided a loan to the corporation as evidenced by a promissory note in the amount of \$6,678,595 due February 24, 1999 at 4.50 percent per annum. This note was renewed on February 25, 1999, with a due date of March 26, 1999. The note was renewed again on March 27, 1999 and was structured to have an optional renewal each month. On March 5, 1999, the Medical Center loaned \$250,000 to the Corporation, which was to be due December 31, 1999, bearing interest at 4.50 percent per annum. Effective September 15, 1999, Blue Ridge Health Alliance revised its Shareholders' Agreement to provide additional capital and to affect a transfer of shares among the shareholders. Under this agreement, the debt owed to the Medical Center was converted to capital. Also, HSF agreed to provide an additional capital contribution of \$12,455,210. Once this contribution has been made by HSF, the University and the HSF will each own 47.70425 percent of the class A common stock. In addition, the University will transfer to HSF one share of class B common stock so that both HSF and the University will each own one of the two shares, which have been authorized.

The net investment in Blue Ridge Health Alliance is summarized below. Complete financial statements for Blue Ridge Health Alliance, Inc. can be obtained from the corporate offices: 1807 Seminole Trail, Suite 201, Charlottesville, Virginia 22901.

Central Virginia Health Network, Inc.

In May 1995, the Medical Center joined the Central Virginia Health Network, Inc. (CVHN), a partnership of eight Richmond area hospitals. Central Virginia Health Network was formed to provide an efficient and coordinated continuum of care, with services ranging from acute hospital treatment to primary physician care and home health services.

The Medical Center originally paid \$100 for 10,000 shares of common stock and \$109,900 as additional paid-in capital. In addition, the Medical Center is obligated for monthly dues to Central Virginia Health Network of \$8,375. The net investment in CVHN is summarized below. Complete financial statements can be obtained from the registered agent: Steven D. Gravely, Esq., Mezzullo and McCandlish, Post Office Box 796, Richmond, Virginia 23206.

University of Virginia/HEALTHSOUTH L.L.C.

The Medical Center entered into a joint venture with HEALTHSOUTH Corporation to establish an acute rehabilitation facility. The new facility, located at the Fontaine Research Park in Charlottesville, Virginia, provides patient services to the region. The Medical Center made a capital contribution of \$2,230,000 to capitalize the joint venture in May 1996, which represents a 47.7 percent interest in the joint venture. The net investment in HEALTHSOUTH is summarized below. Complete financial statements can be obtained from the managing member: HEALTHSOUTH Corporation, 7700 East Parham Road, Richmond, VA 23294.

Valiance Health, L.L.C.

In November 1997, the Medical Center became a participant with Rockingham Memorial Hospital and Augusta Health Care, Inc. in Valiance Health, L.L.C. (Valiance), a joint venture engaging in the business of integrating and coordinating the delivery of health care services in Central and Western Virginia. The Medical Center contributed \$100,000 in initial capital, which entitles it to a pro-rata distribution of any profits and losses of Valiance.

<u>As of June 30, 1999</u>				
<u>Description</u>	<u>Blue Ridge Health Alliance</u>	<u>Central Virginia Health Network</u>	<u>HEALTHSOUTH</u>	<u>Valiance</u>
Common Stock and Equity Contributions	\$ 28,958,170	\$ 232,500	\$2,230,000	\$100,000
Share of Income/(Loss)	<u>(28,733,386)</u>	<u>(110,840)</u>	<u>(1,290,849)</u>	<u>6,264</u>
Net Investment	<u>\$ 224,784</u>	<u>\$ 121,660</u>	<u>\$ 939,151</u>	<u>\$106,264</u>
<u>As of June 30, 1998</u>				
<u>Description</u>	<u>Blue Ridge Health Alliance</u>	<u>Central Virginia Health Network</u>	<u>HEALTHSOUTH</u>	<u>Valiance</u>
Common Stock and Equity Contributions	\$23,958,170	\$ 232,500	\$2,000,000	\$100,000
Share of Income/(Loss)	<u>(23,207,467)</u>	<u>(75,568)</u>	<u>(254,300)</u>	<u>-</u>
Net Investment	<u>\$ 750,703</u>	<u>\$ 156,932</u>	<u>\$2,254,300</u>	<u>\$100,000</u>

HealthCare Partners, Inc.

In May, 1995, HealthCare Partners, Inc. (HealthCare Partners), a non-stock, non-profit corporation, was established to support networking, external business relationships with neighboring hospitals and physicians groups, and expansion of primary care activities. The Medical Center and the Health Services Foundation are the primary contributors to the funding of the corporation. The corporation is governed by a board of directors composed of Health Sciences Center staff, community members, and University Board of Visitors appointees.

8. GOODWILL

On October 1, 1997, the Medical Center acquired from the University of Virginia Health Services Foundation the Medicine Clinical Laboratories in a transaction accounted for as a purchase. Accordingly, \$1,800,000 was recorded as goodwill and is being amortized over five years.

9. COMMITMENTS

Future minimum lease payments by year and in the aggregate under operating leases are:

<u>Year Ending June 30,</u>	<u>Operating Leases</u>
2000	\$1,966,422
2001	1,404,575
2002	1,212,072
2003	711,293
2004	252,646
Subsequent years	<u>64,777</u>
Total	<u>\$5,611,784</u>

The total rental expense for operating leases for the years ended June 30, 1999 and 1998, was \$6,172,279 and \$4,702,451, respectively.

The Medical Center was party to construction contracts and commitments for the years ended June 30, 1999 and 1998, totaling \$6,882,238 and \$1,357,121, respectively. Of these amounts, \$2,451,818 and \$689,895 were incurred as of June 30, 1999 and 1998, respectively.

The Medical Center entered into various contracts for services and equipment maintenance. These obligations mature as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2000	\$5,019,457
2001	1,704,692
2002	292,406
2003	76,123
2004	64,179

10. UNIVERSITY ALLOCATIONS

The University of Virginia School of Medicine faculty assists the Medical Center in its mission of providing health care and medical education. A survey is conducted annually to determine the value of this effort. An allocation is made on the Medical Center's Statement of Revenues and Expenses to reflect the value of this effort as income. This allocation is offset in the operating expenses of the Medical Center by an equal amount in purchased services. The amount of this allocation for the years ended June 30, 1999 and 1998 was \$7,416,514 and \$16,834,303, respectively.

Likewise, the University provides the Medical Center various general and administrative support services. An analysis is prepared annually to determine the cost of providing these services. The same type of allocation as above is made to the Medical Center Statement of Revenues and Expenses to reflect the difference between the direct charge to the Medical Center and the actual cost of these services. The amount of this allocation for the years ended June 30, 1999 and 1998, was \$922,402 and \$1,209,878, respectively.

Although these allocations have no direct effect on Income from Operations, they do affect the Medical Center's reimbursement from third-party payors by increasing allowable costs.

11. UNIVERSITY OF VIRGINIA HEALTH SERVICES FOUNDATION

The University of Virginia Health Services Foundation, a nonprofit educational, scientific, and charitable organization, began operating with the approval of the Board of Visitors as of June 30, 1980, to assist the University in providing hospital and medical care services, medical education programs, and programs of public charity at the University of Virginia. Beginning July 1, 1994, the Foundation assumed all costs associated with the operation of the outpatient clinics.

The Foundation paid the Medical Center \$744,727 and \$335,523 for rental of space for the clinics for the years ended June 30, 1999 and 1998, respectively. The Medical Center paid the Foundation \$8,206,931 and \$9,850,914 for costs associated with the operation of the outpatient clinics and \$19,880,269 and \$21,464,391 for the provision of supervisory and administrative services for the years ended June 30, 1999 and 1998, respectively. Also, the Medical Center paid the Foundation \$649,493 and \$1,484,813 for rental of space and \$4,331,564 and \$3,661,884 for other services for the years ended June 30, 1999 and 1998, respectively.

12. CONTINGENCIES - MEDICAL MALPRACTICE CLAIMS

The Medical Center is a participant in the Commonwealth of Virginia's self-insurance program. Participation in this program provides the Medical Center with insurance under an "occurrence" policy for institutional and professional liability with a liability limit of \$1,500,000 per occurrence and with no limit of aggregate annual liability for each policy year. The Commonwealth of Virginia has a \$1,500,000 limit on malpractice awards. In the opinion of management, such coverage is adequate to provide for the ultimate liability, if any, which might result from the settlement of claims currently asserted against the Medical Center, as well as the potential liability for medical incidents of which the Medical Center has knowledge but for which claims have not yet been asserted against the Medical Center. Accordingly, no provision is included in the financial statements for such potential liabilities.

Sufficient information has not been developed by the Medical Center to provide a reasonable basis for estimation of the potential liability for incurred medical incidents, which have not been reported to the Medical Center; however, in the opinion of management, any potential liability for unreported medical incidents is not expected to have a material effect on the financial position of the Medical Center.

### 13. DEFEASANCE OF DEBT

In 1985, the Medical Center defeased Hospital Revenue Bonds, Series A and Series B, by placing the proceeds of Hospital Revenue Refunding Bonds, Series C and Variable Rate Demand Revenue Refunding Bonds, Series D, in an irrevocable trust to provide for all future debt service payments on the Series A and Series B Bonds. In 1989, the Medical Center advance refunded \$60,686,796 of outstanding Series C Revenue Refunding Bonds and \$2,810,855 of accrued interest on GAINS securities, by placing the net proceeds of Series E Revenue Refunding Bonds in an irrevocable trust to provide for all future debt service payments on the refunded portion of the Series C Bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Medical Center's financial statements. The defeased Series A and Series B Bonds outstanding was \$6,556,000 as of June 30, 1999 and 1998. The defeased Series C Bonds outstanding were \$6,291,796 as of June 30, 1999 and 1998.

In 1992, the Medical Center defeased \$12,415,000 of Series E Bonds that are stated to mature on June 1, 2010. An escrow account was established with proceeds from the Construction Fund and gifts to the Medical Center restricted for use in connection with the replacement hospital project. The proceeds were used to purchase U.S. Government securities and were deposited in an irrevocable trust with an escrow agent to provide for the debt service payments on the refunded portion of the Series E Hospital Revenue Refunding Bonds. As a result, the 1989 Series E Hospital Revenue Refunding Bonds designated above as being refunded were considered defeased at June 30, 1998 and are not reflected in the accompanying financial statements. As of June 30, 1998, \$12,415,000 of the defeased Series E bonds remained outstanding and were redeemed on June 1, 1999.

On March 3, 1999, the University issued on behalf of the Medical Center \$51,985,000 in series 1999A General Revenue Pledge Bonds to advance refund \$55,875,000 of outstanding Series E Hospital Revenue Refunding Bonds. The net proceeds together with the funds available in the depreciation reserve fund were used to purchase U.S. Government securities. These securities were deposited in an irrevocable trust with an escrow agent to provide for the redemption of the 1989 Series E Revenue Refunding Bonds. The refunded Series E Bonds were redeemed on June 1, 1999. Though the advanced refunding resulted in the recognition of an accounting loss of \$2,925,551 for the year ended June 30, 1999, the Medical Center in effect reduced its aggregate debt service by \$13,664,428 over the next 14 years. This represents a net present value savings of \$5,475,598.

14. LONG-TERM DEBT

	Interest Rate	Maturity	As of June 30	
			1999	1998
Series 1998B	3.5% to 5%	1998-2018	\$ 6,525,000	\$ -
Series 1993A	4% to 5.2%	1998-2015	36,770,000	40,175,000
Series 1999A	4.5% to 5.25%	1999-2013	51,985,000	-
Series 1989E	6% to 7%	2001-2013	-	55,875,000
Leasehold improvement obligations			<u>59,400</u>	<u>146,900</u>
Total indebtedness			<u>\$95,339,400</u>	<u>\$96,196,900</u>

Total indebtedness matures as follows:

2000	\$3,834,400
2001	4,060,000
2002	4,245,000
2003	4,430,000
2004	4,625,000
Subsequent years	<u>74,145,000</u>
Total	<u>\$95,339,400</u>

On November 24, 1998, the University issued on behalf of the Medical Center \$6,525,000 of 1998B General Revenue Pledge Bonds. The proceeds together with additional funds provided by the Medical Center were used to finance the acquisition of the Virginia Musculoskeletal Center located at the Fontaine Research Park in Charlottesville, Virginia. The facility contains 44,000 square feet and will house clinics for the following departments: Orthopedics, Radiology, Rheumatology, Physical Medicine and Rehabilitation and Pain Management. The University took ownership of the building on August 24, 1999.

15. RETIREMENT PLANS

Employees of the Medical Center are employees of the Commonwealth. Substantially all full-time classified salaried employees participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). Information relating to this plan is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth, not the Medical Center has overall responsibility for contributions to this plan.

Substantially all full-time faculty, including certain administrative staff, and Health Care Professionals participate in Faculty Optional Retirement Plans. These are fixed-contribution plans where the retirement benefits received are based upon the employer and employee contributions (all of which are paid by the Medical Center), and the interest and dividends. Individual contracts issued

under the plans for full time faculty, including certain administrative staff, provide for full and immediate vesting of both the Medical Center's and the participant's contributions. Health Care Professional's employer contributions fully vest after one year of employment. Total pension costs under the plans were \$5,694,476 and \$4,806,655 for the years ended June 30, 1999 and 1998, respectively. Contributions to the Optional Retirement Plans were calculated using base salaries of \$67,153,807 and \$57,977,415 for the years ended June 30, 1999 and 1998, respectively. The contribution percentage amounted to 8.5% and 8.3% for both years ended June 30, 1999 and June 30, 1998, respectively.

16. POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Commonwealth participates in the VRS administered statewide group life insurance program that provides post-employment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least 15 years of state service and participate in the state health plan. Information related to these plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

17. SELF-INSURANCE

The University sponsors a self-funded, comprehensive program of medical care benefits as an option for Health Care Professionals employed by the Medical Center. The program was offered to all employees of the University and the Medical Center. Fringe benefit expenses include estimates for claims that have been incurred but not reported.

18. SURETY BOND

Medical Center employees are covered for Faithful Performance of Duty in the amount of \$500,000 for each loss under a self-insurance program administered by the Commonwealth of Virginia's Department of General Services, Division of Risk Management. Detailed information relating to this policy is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

19. YEAR 2000 COMPLIANCE

The Medical Center recognizes the significance of the Century Date Change and the impact Year 2000 may have on its information technology and business infrastructure. The Medical Center has established a Year 2000 task force, consisting of department heads and various other employees, to oversee specific technical efforts associated with the Year 2000 phenomenon and to assist with meeting the requirements of the Commonwealth of Virginia.

The Medical Center identified the administrative computer systems as mission critical and is subjecting its mission critical systems to the following stages of work to address year 2000 issues:



Awareness – Define the Year 2000 problem and gain executive level support and sponsorship. Establish Year 2000 project team and develop an overall strategy. Ensure that everyone in the University is fully aware of the issues.

Assessment – Assess the Year 2000 impact on the University. Identify priority business activity, inventory and analyze systems supporting these activities, and prioritize their conversion or replacement. Develop contingency plans to handle potential system failures. Identify and secure the necessary resources.

Remediation – Convert, replaces, or eliminates selected systems. Modify interfaces.

Testing and Validation – Test, verify, and validate converted or replaced systems. Test the performance, functionality and integration of these systems and interfaces in an operational environment.

Implementation – Define transition procedures and develop implementation schedule. Complete acceptance testing and develop contingency plans. Implement converted and replaced systems.

As of June 30, 1999, the Medical Center has several hourly contracts in place to complete the remediation, testing and validation, and implementation phases. The Medical Center has spent \$1.63 million to date and estimates spending another \$370,000 in order to complete this work.

UNIVERSITY OF VIRGINIA MEDICAL CENTER  
Charlottesville, Virginia

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